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## Foreign Acquisitions of U.S. Companies

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Fort McNair, Washington, D.C. 20319-6000

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# REPORT DOCUMENTATION PAGE

1a. REPORT SECURITY CLASSIFICATION UNCLASSIFIED			1b. RESTRICTIVE MARKINGS		
2a. SECURITY CLASSIFICATION AUTHORITY N/A			3. DISTRIBUTION/AVAILABILITY OF REPORT Distribution Statement A: Approved for Public Release; distribution is unlimited.		
2b. DECLASSIFICATION/DOWNGRADING SCHEDULE N/A					
4. PERFORMING ORGANIZATION REPORT NUMBER(S)  NDU-ICAF-95- 211			5. MONITORING ORGANIZATION REPORT NUMBER(S)  N/A		
6a. NAME OF PERFORMING ORGANIZATION Industrial College of the Armed Forces		6b. OFFICE SYMBOL (If applicable) ICAF-AR	7a. NAME OF MONITORING ORGANIZATION National Defense University		
6c. ADDRESS (City, State, and ZIP Code) Fort McNair Washington, D.C. 20319-6000			7b. ADDRESS (City, State, and ZIP Code) NDU-LD-SCH Ft. McNair Washington, D.C. 20319-6000		
8a. NAME OF FUNDING/SPONSORING ORGANIZATION N/A		8b. OFFICE SYMBOL (If applicable)	9. PROCUREMENT INSTRUMENT IDENTIFICATION NUMBER  N/A		
8c. ADDRESS (City, State, and ZIP Code)			10. SOURCE OF FUNDING NUMBERS		
			PROGRAM ELEMENT NO.	PROJECT NO.	TASK NO.
			WORK UNIT ACCESSION NO.		
11. TITLE (Include Security Classification) <i>Foreign Acquisitions of U.S. Companies</i>					
12. PERSONAL AUTHOR(S) <i>Syed Anwar Karim</i>					
13a. TYPE OF REPORT Research		13b. TIME COVERED FROM <i>Aug 94</i> TO <i>Apr 95</i>		14. DATE OF REPORT (Year, Month, Day) 1995 April	
15. PAGE COUNT <i>36</i>					
16. SUPPLEMENTARY NOTATION					
17. COSATI CODES			18. SUBJECT TERMS (Continue on reverse if necessary and identify by block number)		
FIELD	GROUP	SUB-GROUP			
19. ABSTRACT (Continue on reverse if necessary and identify by block number)  See Attached					
20. DISTRIBUTION/AVAILABILITY OF ABSTRACT <input type="checkbox"/> UNCLASSIFIED/UNLIMITED <input checked="" type="checkbox"/> SAME AS RPT. <input type="checkbox"/> DTIC USERS			21. ABSTRACT SECURITY CLASSIFICATION UNCLASSIFIED		
22a. NAME OF RESPONSIBLE INDIVIDUAL Susan Lemke or Tina Lavato			22b. TELEPHONE (Include Area Code) (202) 287-9458		22c. OFFICE SYMBOL NDU-LD-SCH

DTIC QUALITY INSPECTED 6

# **Foreign Acquisitions of U.S. Companies**

**Syed A. Karim**

## **Abstract**

There has been a significant increase in foreign direct investment (FDI) in the United States. The United States has traditionally pursued an open door policy towards FDI. However, there is a growing congressional fear that foreign acquisitions are sometimes motivated by a desire to obtain technology, and sometimes result in the takeover of technologies considered critical to national security. There has been loss of U.S. high technology industries whose research and development could have an impact on national defense. In support of the tightening of technology controls, especially in licensing of firms selling dual-use items, the Pentagon and the CIA released reports about illegal transfers and dramatic interceptions of controlled national security technologies. Cases of diversion included very high speed integrated circuits, sonar devices, nuclear triggers, and long-range cannon tubing. This paper looks into the background of foreign acquisitions, the Exon-Florio amendment which empowers the President to deny a foreign takeover, and the loss of U.S. industries.

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## BACKGROUND

Why foreign acquisitions of U.S. companies? The value of the dollar has shrunk in relation to the world's other major currencies making U.S. companies increasingly attractive to foreign investors. Many companies which underwent leveraged buyouts in the early 1980s now need capital to finance their debt; others, in efforts to avoid hostile takeovers, are selling off subsidiaries and divisions. In both situations foreign investors are attractive potential purchasers because they have the capital. The stock market crash in the fall of 1987 further intensified U.S. companies need to obtain capital. The British, followed by Dutch, the Japanese and the French are the leading investors in the United States.

The 1992 data<sup>1</sup> available as a result of an ongoing project between the Bureau of Economic analysis and the Bureau of the Census, sheds important new light on the characteristics of foreign investments and help answer some key questions. How much of U.S. industry is owned by foreign companies? The data indicates that foreign-owned establishments accounted for only 4 percent of the employment of U.S. businesses. In manufacturing, foreign-owned establishment's employment share was 7 percent. In nearly one-half of 459 detailed manufacturing industries, foreign-owned establishment's employment share was less than 5 percent; their employment share exceeded in only 5 percent of these industries. In a very small number of industries, these establishments accounted for over 50 percent of all U.S.- business employment.

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<sup>1</sup> Foreign Direct Investment in the United States: Establishment data for 1987. Nel G. Howenstine, William J. Zeile, Survey of Current Business, Oct 1992. P44-45.

Where do foreign companies locate their U.S. operations? Over one-fourth of the employment by foreign-owned establishments is in three States - California, New York and Texas; their share of total State employment is largest in Delaware (13 percent) and Hawaii (7 percent). Do foreign-owned establishments employ larger amounts of capital and skilled labor than other establishments? They tend to be in industries that rely more on physical capital (plant and equipment): The average employment share for foreign-owned establishments was significantly higher in the 50 most capital-intensive manufacturing industries than it was in the 50 least capital intensive - 15 percent, compared with 4 percent. Similarly, they tend to be industries that have a more skilled labor force.

Do foreign-owned establishments spend relatively more for research and development than other establishments? This cannot be measured directly; however, foreign-owned establishments tend to be concentrated in the U.S. industries with the most research and development activity. In the manufacturing industries with the highest research and development activity, the average share of total employment for foreign-owned establishments was 12 percent, considerably above their average employment share of 7 percent in all other manufacturing industries. How does the compensation of employees of foreign-owned business compare with that of U.S.- owned businesses? The payroll per employee of foreign-owned establishments was 29 percent higher than that of U.S. - owned establishments. In manufacturing it was 12 percent higher.

### **United States Concern over Foreign Investment in the U.S.**

The increase in foreign investment in recent years has prompted new concern in some quarters about the value of our open investment policy. Executive order 11858, signed by President Ford in 1975, brought into existence the Committee on Foreign Investment in the

United States (CFIUS). The primary intent of CFIUS was to oversee the trend of foreign investment in the United States, both direct and registered. In its initial form, however, CFIUS served in only an advisory and information-collecting role. The committee could make recommendations, but had no enforcement powers.

The Exon-Florio amendment was introduced in direct response to the Fujitsu/Fairchild and other take over attempts. The statute is structured in three basic parts, the most significant of which authorizes the President, under certain circumstances, to take action to prevent ownership from impairing the national security interest of the United States. This authorization reflects a fundamental change in prior policy and invests the President with a high degree of discretion and power to block foreign acquisitions and mergers. This same section of the statute also authorizes the President to "direct the Attorney General to seek appropriate relief, including divestment relief, in the district courts of the United States in order to implement and enforce" the provisions of the Exon-Florio amendment.

The second principal section of the statute enumerates the factors that the President or his designee may consider in determining whether a foreign acquisition, merger, or take over impairs national security: (1) Domestic production needed for projected national defense requirements, (2) the capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services, and (3) the control of domestic industries and commercial activity by foreign citizens as it effects the capability of the United States to meet the requirements of national security.



The third principal element of the Exon-Florio amendment consists of the notification and investigation procedures it established for the exercise of the presidential prerogatives created under the statute. The statute establishes a three "gate" time table:

- (I) The first 30 days following notice: The president or his designee has up to 30 days to decide whether to conduct an investigation;
- (ii) Forty-five days following a decision to investigate: The president or his designee, following a decision to investigate, has 45 additional days in which to complete the investigation;
- (iii) Fifteen days following completion of the investigation: Following completion of the investigation, the President has fifteen days in which to decide (a) whether and with what possible limitations a proposed transaction should be permitted to proceed, or (b) in the case of completed transactions, whether, and if so, how any actual or threatened impairment of the national security can be corrected.

Thus the Exon-Florio amendment creates a potential 90 day "window of vulnerability" for transaction with foreign purchasers.

After the congress passed the Exon-Florio amendment, President Reagan initially designated the Secretary of the Treasury to implement the provisions of the statute on an interim basis. Soon thereafter, Reagan amended Executive Order 11858 to designate CFIUS as the agency responsible for implementing the statute's provisions. The amendment to the executive order also added the Attorney General and the Director of the Office of Management and Budget as members of CFIUS. Thus, at the present time, CFIUS consists of eight members: Secretary of State, Secretary of the Treasury, Secretary of Defense, Secretary of Commerce, Assistant to the

President for Economic Affairs, Executive Director of the Council on International Economic Policy, Attorney General, and the Director of the Office of Management and Budget.

**Defense Department Participation:** Defense is represented on the CFIUS by a senior staff member of the Defense Trade Security Agency (DTSA). Notifications to CFIUS of a transaction are coordinated throughout DOD with the services and various component offices. These include the Defense Investigative Service, Office of the Under Secretary for Acquisitions, Defense Logistics Agency, and others as appropriate. Each component examines the transactions, raises questions, and makes comments and recommendations to DTSA, which develops the Department of Defense position.

**Security:** National security was not defined in the amendment and was thereby left to interpretation. Normally, there is also a lack of data to accurately assess, the full security implications that may result in a company title transfer to a foreign entity. Classified contracts, under normal security arrangements, will most likely be safeguarded through contract clauses that require change of ownership reporting. When ownership changes, a new industrial security investigation is done by the Defense Investigative Service (DIS).

Normally, the new owners reach an agreement with DIS that allows classified work to continue. Only when new owners refuse to work such an agreement is contract termination likely. Acceptable agreements involve use of board resolution, voting trusts, proxy agreements, reciprocal clearances or special security agreements.

**Limitations:** The most judicially enforceable limitations on executive discretion under Exon-Florio are the procedural requirements, and U.S. international obligations. Existing commitments under treaties prohibiting barriers to international investments are binding on the

President in his application of Exon-Florio. Although these treaties contain exceptions allowing for parties to take actions for protection of essential security interests, decisions to invoke these exceptions sometimes may be overturned by the International Court of Justice. The strict system of deadlines within which the President must initiate and complete his investigation, and decide whether or not to act under the statute, also provides parties resisting CFIUS intervention with a potent justifiable issue to delay or prevent executive branch action under Exon-Florio.

### **Why 'The Exon-Florio Amendment'?**

On August 23, 1988, a provision amending Title VII of the Defense Production Act of 1950<sup>2</sup> was enacted into law as part of the Omnibus Trade and Competitiveness Act of 1988.<sup>3</sup> The provision, usually referred to as the Exon-Florio amendment, gives the President new authority to investigate and block foreign takeovers of U.S. companies if he determines that U.S. national security could be threatened.

Exon-Florio grew out of the controversy surrounding the attempted acquisition of Fairchild Industries, a silicon valley semiconductor manufacturer, by Fujitsu, a Japanese computer company in 1986.<sup>4</sup> Fairchild produced a number of sophisticated electronic components used in aircraft, missile guidance, strategic defense research, and super computers made for encryption

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<sup>2</sup> 50 United States Code. App. 2158 et seq

<sup>3</sup> see Section 721 of Pub. L. 100-418, 102 stat. 1107, to be codified at 50 U.S.C. app. 2170 (hereafter cited in U.S. code form).

<sup>4</sup> see floor statement of James J. Florio on Trade Bill of 1988, 21 April 1988, at 6. See also statement of J. James Exon, Congressional Record, April 27, 1988, at S. 4833.

and decryption.<sup>5</sup> The controversy resulted from mounting concerns that U.S. defense suppliers were generally becoming too dependent on the Japanese for semi conductors.<sup>6</sup>

U.S. defense contractors in competition with Fujitsu depended on Fairchild as the sole source for unique subcomponents necessary for fulfilling defense contracts. As a result, there was apprehension within the defense community that, Fujitsu might have economic incentives to cut off Fairchild's production of subcomponents from firms Fujitsu was in competition with. Moreover, the Toshiba-Koningsberg sale of sensitive manufacturing technologies to the Soviet Union was much in the news at that time, and led to concern that Japanese control of firms like Fairchild could result in further damaging transfers of technologies to the Eastern Bloc.

Fujitsu's attempted acquisition of Fairchild was part of a much broader investment trend. As a result of a favorable exchange rate, Japanese investors saw increasing opportunities to buy U.S. assets cheaply.<sup>7</sup> American firms specializing in high technology were a particularly attractive investment for Japanese high tech firms, who were concerned that the decline of the dollar against the yen might price Japanese high-tech exports out of the American market. Moreover, at the time of the sale, U.S. semiconductor manufacturers, including Fairchild, were weakened by slumping sales.<sup>8</sup> The price of stock in these companies had been driven down by their recent losses, making investments even more of a bargain for the Japanese. By investing in

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<sup>5</sup> J. Woodruff, "A Global Affair: Japanese Clout in U.S. Business Causes Unease," The (Baltimore) Sun 15 January 1989, E1-E9.

<sup>6</sup> Bureau of National Affairs, "New Omnibus Trade Law said to offer Weapon Against Foreign Takeover Bids," Daily Report for Executives, 7 November 1988. Ironically, as set forth below in greater detail, Fairchild was already a subsidiary of the French holding company Schlumberger.

<sup>7</sup> 134 Congressional Record S 4833 (daily ed. April 27, 1988) (statement of Senator Exon)

<sup>8</sup> B. Schlender and S. Yoder, "Chip Makers See New Thrust From Japanese Firms: Fujitsu's Plan to Merge with Fairchild Stirs Concern," The Wall Street Journal, 27 October 1986.

working production facilities within the U.S., the Japanese could take advantage of reduced prices for production inputs inside the U.S., expanding their profits and their market share. As additional incentives, production footholds within the U.S. would give the Japanese improved access to U.S. technological advances, and would serve as hedge against possible future import barriers into the U.S. The government of Japan was actively pushing Japanese firms to take advantage of these opportunities in order to recycle accumulated capital, and blunt foreign criticism of Japan's current account surplus.<sup>9</sup> By the end of 1987 Japanese investment in the U.S. had risen to \$33 billion, a 195 percent increase from five years before.<sup>10</sup> The broader controversy over rising Japanese direct investment in the U.S. found expression in the debate about the national defense implications of the Fujitsu-Fairchild merger, and the merger deal became an important political issue.<sup>11</sup>

Under the International Emergency Economic Powers Act (IEEPA),<sup>12</sup> the President had the authority to block the foreign acquisition of Fairchild, if he determined there was an extraordinary threat to U.S. national security, foreign policy, or the economy.<sup>13</sup> However, given the relative magnitude the national security concerns involved, the diplomatic consequences of such a move would have been prohibitive. Action under the IEEPA would have required the

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<sup>9</sup> Department of Commerce, Office of Japan, Japanese Investment Strategy In the U.S., at 1 (1983).

<sup>10</sup> See Woodruff, at E9.

<sup>11</sup> Id.

<sup>12</sup> 50 U.S.C. 1701. et seq.

<sup>13</sup> Foreign Takeovers and National Security: Hearing Before the Subcom. On Commerce, Consumer Protection, and Competitiveness of the House Comm. On Energy and Commerce, 100th Cong., 1st Sess. 17-18 (1988) (Statement of J. Michael Farren, Deputy Under Secretary for International Trade, Department of Commerce).

President to declare a national emergency with respect to the transfer,<sup>14</sup> an action that would be perceived to be "Virtually the equivalent of a declaration of hostilities against the government of the acquirer company."<sup>15</sup> Moreover, it would have involved labeling the acquisition of Fairchild by a Japanese company an "Unusual and extraordinary threat"<sup>16</sup> when Fairchild had been owned by Schlumberger Ltd., without a peep of protest from the U.S. for the previous seven years. Although Schlumberger had significant holdings in the U.S., it was organized under the laws of Netherlands-Antilles, with significant interests owned by the Schlumberger family in France. An action which demonstrated such significant prejudice against Japanese ownership as compared to European ownership might have been the opening of a U.S.- Japanese trade war that would have been far worse for U.S. national security than any damage from the takeover.

The Administration explored the possibility of blocking the merger under the U.S. antitrust laws. However, the Justice Department did not find any serious restraint of trade problems arising from the merger. Under applicable antitrust law, mergers involving foreign firms need not pass any antitrust standard than mergers between U.S. companies.

The administration also explored the possibility of forging an agreement directly with Fujitsu that would have guaranteed that Fairchild continue to produce semiconductor components used for defense purposes for a period of years, and set minimum levels for capital investment in Fairchild operations, research, and development. The government would enforce such an

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<sup>14</sup> 50 U.S.C. 1701(a).

<sup>15</sup> See Acquisition by Foreign Companies: Hearing Before the Senate Comm. On Commerce, Science and Transportation, S. Hrg. 100-223, 100th Cong., 1st Sess. At 17 (1987) (Statement by Sen. Pete Wilson). See, e.g. Exec. Order No. 12205, 45 Fed Reg. 24101 (1980) (Prohibiting certain transactions with Iran).

<sup>16</sup> *Id*

agreement by taking into account any failure by Fujitsu to fulfill its obligations in determining whether Fujitsu had "a satisfactory record of integrity and business ethics" as is required for continued eligibility for U.S. government contracts.<sup>17</sup> But before an agreement could be reached, the political pressure became too burdensome, and Fujitsu broke off its plans for the acquisition.

The Exon-Florio Amendment was promulgated in response to concerns that if the Administration had been forced to follow through on its efforts to block the Fairchild acquisition, it may have been *unable* to do so under existing law without resorting to rather draconian emergency powers.<sup>18</sup> It establishes an intermediate measure for dealing with less "unusual and extraordinary" threats<sup>19</sup> than IEEPA, for cases where existing law is not "adequate and appropriate" for the President to respond to national security concerns.

On December 28, 1988 President Reagan issued an executive order that delegated the primary responsibility for implementing Exon-Florio to the Committee on Foreign Investment in the United States (CFIUS).<sup>20</sup> CFIUS is an interagency group created in 1975 to "review investments in the United States, which, in the judgment of the committee, might have major implications for the United States national interests."<sup>21</sup> It is chaired by the Secretary of the Treasury, and its membership includes the secretaries of Defense, Commerce, and State, the U.S. Trade Representative, the Chairman of the Council of Economic Advisors, the Attorney General,

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<sup>17</sup> Federal Acquisition Regulations, 9.104-1 (d).

<sup>18</sup> See statement of James Florio Before the House Committee on Rules, 20 April 1988, at 2-3.

<sup>19</sup> *Id.*

<sup>20</sup> Weekly Digest of Presidential Declarations, Administration of Ronald Reagan, 1988, December 28, 1988, p. 1663.

<sup>21</sup> Executive Order No. 11858

and the Director of the Office of Management and Budget.<sup>22</sup> Previous to the enactment of the Exon-Florio bill, the group had no formal power to block foreign direct investments. Yet CFIUS review often has resulted in the rectification of national security problems with a transaction either through negotiation with the parties to the transaction, or by focusing attention on the problems so that they could be handled through authority vested in various executive departments under the existing law.<sup>23</sup>

The national Defense context of the Exon-Florio provision requires that the Defense Department play an active role in its implementation.<sup>24</sup> In the legislative history of the measure, congress expressed the clear intent that all government agencies with relevant information cooperate with CFIUS in its investigation, and specified that the CFIUS consult with the Secretary of Defense.<sup>25</sup> In promulgating regulations implementing Exon-Florio, the Chairman of CFIUS is required by executive order to consult with other members of the committees, including the Secretary of Defense.<sup>26</sup> If any member of the CFIUS, including Defense, dissents from a decision not to undertake an investigation, the Chairman of CFIUS is directed to take the matter to the President for decision.<sup>27</sup> Moreover, the Defense Department has historically taken the lead

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<sup>22</sup> Executive Order No. 11858 sec. 1(A) (as amended) Previous to the passage of Exon-Florio, most of CFIUS activities have been carried out at staff level. Most members of the CFIUS staff are employees of the Treasury Department. See Treasury Fully Implementing National Security Provision, Brady says, Bureau of Nationals Affairs' Daily Report for Executives 22 December 1988.

<sup>23</sup> See Foreign Takeovers and National Security: Hearing Before the Subcomm. On Commerce Protection, and Competitiveness of the House Comm. On Energy and Commerce, 100th Cong., 1st Sess., at 20-22 (1988) (prepared statement of David C. Mulford, Assistant Secretary for International Affairs, Department of Treasury).

<sup>24</sup> 50 U.S.C. App. 2170(e).

<sup>25</sup> See H.R. Conf. Rep. No. 576, 100th Cong., 2d Sess. At 927 (1988).

<sup>26</sup> Executive Order No. 11858, sec. 8 (as amended).

<sup>27</sup> Executive Order No. 11858 Sec. 7(1)(c).



in negotiations with parties to transaction in matters involving defense contracts, and classified national defense information.<sup>28</sup> Therefore, the Defense Department should be prepared to play an active role in interagency deliberations over implementation of the measure, and over individual cases as they arise. The U.S. Treasury Department on Nov. 15, 1991 issued the final regulation for the US government review of foreign acquisitions of US businesses under the 'Exon-Florio' law.

### **What Warrants Presidential Intervention:**

#### **A Good Use Of Exon-Florio in MAMCO-CATIC CASE<sup>29</sup>**

The only one case that led to a presidential veto of a proposed foreign acquisition involved the acquisition by China National Aerotechnology Import and Export Corporation (CATIC) of MAMCO Manufacturing Inc. of Seattle. On November 6, 1989 CATIC, which is owned by the Chinese government, notified CFIUS of it's intention to acquire MAMCO for approximately \$20 million. MAMCO machines and fabricates metal parts for use in commercial aircraft, including tail and wing assemblies and various small parts, such as fittings. The Boeing Co. is MAMCO's largest customer, accounting for 85 to 90 percent of its business. MAMCO had no contracts involving classified information, but some of its machinery is subject to U.S. export controls. On November 30, *prior to decision*, CATIC completed the acquisition by acquiring all of MAMCO's

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<sup>28</sup> See Foreign Takeovers and National Security: Hearing Before the Subcomm. On Commerce Protection, and Competitiveness of the House Comm. On Energy and Commerce, 100th Cong., 1st Sess. At 21 (1988) (Statement of David C. Mumford, Assistant Secretary for International Affairs, Department of Treasury).

<sup>29</sup> See "Selling Our Security" by Martin and Susan J. Tolchin. Martin Tolchin is a prizewinning correspondent in the Washington bureau of The New York Times. Susan J. Tolchin is professor of public administration in the School of Business and Public Management at George Washington University. Case (6) P 56-57

outstanding shares. Exon-Florio does not prohibit the parties to a transaction under review from completing an acquisition before receiving government approval, "although prudence would argue against closing a transaction before receipt of the clearance letter." Just four days after completion of the sale, CFIUS, informed CATIC that it would in fact investigate the transaction.<sup>30</sup>

To everyone's surprise, given the low level of technology involved, on January 19, 1990, CFIUS unanimously recommended to the president that he seek the extraordinary measure of divestment. On February 1, Kenneth A. Keller, MAMCO's president, said: "I would be amazed if there were a recommendation against allowing the transaction to stand. I was not aware of anything that we do here that would have any possible impact on national security." Some senior government officials were arguing nullifying the MAMCO sale, partly to avoid angering China.<sup>31</sup>

However, there were indications that CATIC had been used by the Chinese government for some of its intelligence operations inside the United States. On February 2, the president ordered CATIC to divest itself of its interest in MAMCO. In announcing this decision, President Bush said that there was "*credible evidence*" that CATIC's acquisition of MAMCO might impair national security. Several areas of concern were raised, the most credible of which was a concern that CATIC would use MAMCO as a base for intelligence activities in the U.S.

One congressional staff member suggested, "There was a concern that the new owners could have gotten onto the floor of a Boeing Plant." The administration was alarmed by an alleged violation of U.S. export-control laws in 1984, when CATIC purchased two CFM-56

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<sup>30</sup> Martin Tolchin, "U.S. Will Scrutinize a Chinese Deal," New York Times, December 5, 1989. P. D4.

<sup>31</sup> U.S. House of Representatives, Energy and Commerce Committee, Subcommittee on Commerce, Consumer Protection and Competitiveness, Richard Gephardt testimony, February 21, 1991

General Electric aircraft engines. An administration official said that, "Because China had violated an agreement with the British not to take apart another engine in an effort to learn its manufacturing secrets, the United States imposed stringent controls on the 1984 sale." Nevertheless, the Chinese had reportedly disassembled the engines to learn the technological secrets.

The President's action was not a precedent with regards to direct investment from China or any other country, a point made by the White House in its announcement of the President's decision and in the President's report to the Congress. The CATIC/MAMCO transaction was considered on its own merits, as are all notified transactions. The divestment order has no effect on other CATIC investments in the United States, nor does it imply anything about CATIC's other investments.<sup>32</sup> Senator James Exon and newly inaugurated New Jersey Governor, James Florio, hailed the president's action and said it "demonstrates the obvious need" for the law. "The action of MAMCO would have certainly furthered China's military power that was used to brutally crush the Chinese democracy movement," Exon added.<sup>33</sup> According to Dr. James V. Feinerman's article, in *Law & Policy in International Business* Volume 22, "Enter the Dragon: Chinese Investment in the United States" CATIC agreed to sell MAMCO to a U.S. firm, DeCraneAircraft Holding Inc. CATIC continued to maintain the position it took from the outset of the controversy, that its purchase of MAMCO was "solely of a commercial activity" which did not threaten or impair the national security of the United States. It is likely that the advice of its

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<sup>32</sup> See Hearings before the Subcommittee on Commerce, Consumer Protection and Competitiveness of the Committee on Energy and Commerce House of Representatives, 101 Congress second session, March 19, 1990. Statement of Charles H. Dallara, Assistant Secretary of the Treasury For International affairs.

<sup>33</sup> The Washington Post, Saturday Feb 3, 1990, "President Tells China to Sell Seattle Firm." Article written by Stuart Auerbach. Page A9

US counsel convinced CATIC that it would not be successful in challenging CFIUS findings and the presidential directive and that the best course would be compliance with the divestiture order.

### **A Misuse of Exon-Florio**

**Norton's Defense: The British Are Bad, but the French Have a Better Deal<sup>34</sup>**

**OR**

**How an American Company Used Exon-Florio to get a better Deal: Norton-**

**BTR<sup>35</sup>**

Exon-Florio investigation was requested by 119 members of Congress. In a letter to President Bush on April 19, 1990, they expressed their concern over Great Britain's BTR (British Tire and Rubber) PLC's \$1.64 billion, \$75 a-share hostile bid for the Norton Company of Worcester, Massachusetts.

"We urge you" the letter<sup>36</sup> said "to direct the members of your Cabinet who are members of the Committee on Foreign Investment in the United States to investigate the hostile takeover attempt by a British conglomerate, BTR, of Norton, a company headquartered in Worcester, Massachusetts with operations in twenty other states. In our *collective* judgment there are *critical national security, and international competitiveness* issues that require a thorough and careful review. Norton's products, supplied under contract to the Defense Department include radomes, missile domes, advanced ceramic high technology bearings and ceramic aircraft engine parts. In addition, Norton is at its leading edge in the development of technology critical to the future of U.S. weaponry and advanced electronics. Frankly, we do not believe that any take over of Norton would be in our economic security or national security interest. It would be a sad day if we fail to act to protect Norton, a company that represents the best of what we hope others might one day achieve".

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<sup>34</sup> The Washington Post, Article written by John Burgess, Wednesday, May 2, 1990, "Norton's Defense: The British Are Bad, but the French Have a Better Deal." See Viewpoint in section G.

<sup>35</sup> See footnote 29; case 8, p 58-59

<sup>36</sup> Letter to the President, from Congress of the United States, House of Representatives, April 19, 1990.

Senator John Kerry, Massachusetts Democrat, in a letter to President Bush on April 2, 1990, urged that the transaction be blocked because Norton was "one of the Pillars of the Massachusetts economy." Al Joseph, a physicist and former executive with Rockwell who was one of the developers of gallium arsenide, explained that Norton was the leading manufacturer of the ceramic balls that went into bearings, and that the company's ceramic bearings were the main ones used in the space shuttle, and helped determine the lifetime of the shuttle in space. The president was being told by Capitol Hill that national security and economic security both would be threatened by this foreign acquisition.

Something suddenly happened. Phones began ringing on Capitol Hill; it was Massachusetts's Norton Company calling with breathless news for its many friends in Congress: The heat is off, Norton said, a "*White Knight*" had stepped forward to save the company from a British conglomerate that had been circling with an uninvited \$1.6 billion buyout offer. Not too many days before, Norton had been on the hill arguing that the predator, BTR PLC, should be blocked by the government on national security grounds. Norton's specialized skills in advanced technology - many with defense applications *should not pass into foreign hands*, the company counseled.

The "*White Knight*" which had stepped forward to save Norton was France's Compagnie de Saint-Gobain which offered \$90 a share, a good deal more than the British company which had offered \$75 a share. Saint-Gobain's offer was much more appealing to the Norton *shareholders* than any argument about national security... Although the French company was as foreign as the British, not an eye brow was raised and no one protested the French acquisition. As far as Norton

was concerned, the congressmen had served their purpose and Exon-Florio could be laid to rest for another day. One has to ask, however, how much *national security* had to do with Norton's cries and the alarm to rally the legislators against the British company. But now, the US company managers know that when they have a foreign buyer who is not making an attractive offer, they can stop the acquisition by tossing the Exon-Florio amendment. In creative hands, they can find new and potentially abusive applications as a general purpose defense against foreign take overs. We see a true misuse of the Exon-Florio amendment.

## **Department of Defense**

### **Review Process of Foreign Acquisition Cases by the Department of Defense**

Defense is represented on the CFIUS by the Defense Technology Security Agency (DTSA). As soon as notification to CFIUS of foreign acquisition transactions are received from Treasury they are immediately coordinated throughout DoD with the three Services and various component offices. These include:

- Defense Investigative Service to determine if there is classified work at the U.S. entity and whether the necessary arrangements are being made to protect it from foreign ownership, control and influence (FOCI).
- Office of the Under Secretary for Acquisitions, Office of Industrial Base Assessment, to evaluate what impact on the defense industrial base may result from the transaction.
- ARPA to evaluate the technology and its relationship to defense programs.

- Defense Logistics Agency to see what, if any, effect the transaction may have on defense procurement and planing.
- Office of Assistant Deputy Under Secretary for Policy Planning, Counter Intelligence and Security, and the General Counsel are consulted for defense policy issues as well as National Security Administration. When appropriate, other technical and policy areas participate on specific issues, e.g. telecommunications, transportation logistics, stockpile, etc. International Security Administration Country Desk officers are contacted when foreign policy issues are involved.

As a minimum, the foreign acquisition case provided to the defense agencies contains the following information about the acquirer and the US company.

- There is a brief description of the acquisition transaction, including identity of all parties involved, timing, and size of the transaction (value and production capacity). Included is the full address and a phone contact for each party to the transaction including relevant subsidiaries and divisions.
- Identification of the acquiring firm by registered name, nationality, and annual sales; description of its business (by three digit U.S. SIC code, where feasible) and its structure (including locations of facilities); key personnels such as president, chairman, division chief, for interest of 5% or more the firm's ownership (by name and nationality), as well as its ultimate beneficial ownership (by name, nationality and address).
- Identification of the firm to be acquired by registered name, nationality, and annual sales; description of its business (by three digit SIC code, where feasible) and its structure (including location of facilities).

- If the acquiring firm has or has not made a Hart-Scott-Rodino<sup>37</sup> filing, if not do they plan to do so.
- If the firm being acquired or any of its subsidiaries is engaged in classified work for the Department of Defense or other government agencies? If so, has appropriate arrangements in accordance with International Traffic in Arms Regulation been made with the Munitions controls office of the Department of State?
- If the firm being acquired or any of its division holds any validated export license from the Export Administration Bureau of the Commerce Department? If so, are the acquiring parties aware of the licensing requirements of the Export Administration Act which are affected by a change in ownership/control?
- Is the company being acquired a supplier or producer for any "authorized programs" under the Defense Production Act of 1950. Does the company customarily receive "rated orders" under the Defense Priorities and Allocations System?
- A brief description is provided of the new owner's plan to increase, reduce or eliminate the acquired firm's efforts in R&D, production, facilities, or product quality for defense-related goods or services, or for goods and services otherwise effecting national security. Regarding such products and services the plan of the new owners to shut down, move offshore, relocate within the United States, consolidate, or sell product lines or service, technology, or R&D.

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<sup>37</sup> The Hart-Scott-Rodino law requires companies planning to acquire assets of \$15 million or more, or a 15 percent stake in another company's securities, to get the approval of the Federal Trade Commission



- Information is provided about the new owners plan to continue to supply the Department or other agencies and their contractors with the same items currently supplied, manufactured to required specifications
- The company to be acquired and the acquiring companies provide their company reports, press release and other relevant information.

Each DoD component examines the transactions, raises questions, and makes comments and recommendations<sup>38</sup> to DTSA which uses them together with its various technical and intelligence resources to develop the Defense Department position.

The Exon-Florio Provision contains mandated time constraint for this review. Thirty calendar days are designated for the initial review. DoD receives the case from Treasury on the first or second day. It is immediately sent to various DoD offices with a request to submit questions within one week and a recommendation in two. This gives DTSA about four or five working days to develop the Defense position and respond to the Treasury by the 23rd day. On the 25th day a report must go to the President informing him of what action is recommended by the committee. If none of the member agencies find any negative affects on national security, the President is so informed and the review is terminated at the end of the 30-day period.

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<sup>38</sup> A typical recommendation is as follows. In June of 1989, Air Force reviewed case 1-19452/89, the foreign acquisition of DK Gleason Inc., a U.S. company by Diesel Kiki Inc. Of Japan. Its recommendation to DTSA was "We do not oppose this acquisition. DK Gleason appears to be mainly a manufacturer of motor vehicle components. While they are involved in manufacture of powder metal parts, metal stampings and precision plastic parts, most of this work is targeted for the commercial market. While the technologies involved have military application, it is believed that the products and technologies from this specific company would not pose a national defense threat if acquired by Diesel Kiki. They have no direct government contracts and are not listed in the Foreign Disclosure and Technical Information System. They indicate they have no classified work." See memorandum from Air Force dated June 1, 1989, to Deputy Under Secretary (Trade Security Policy), Office of the Under Secretary of Defense for Policy, Committee on Foreign Investment in the United States Representatives

If a CFIUS agency requests an investigation because it has reason to believe that the transaction may adversely affect national security, Treasury will convene a meeting at the Assistant Secretary/Deputy Under Secretary level to consider whether the reason presented does, in fact, justify an investigation. If at least three agencies agree, the President is notified. A 45-day period to complete the investigation begins immediately following the end of the 30-day period.

Since the additional 45-day period can impose considerable expense on the parties to the transaction, CFIUS has tried to keep its use to a minimum in order to emphasize its seriousness and to avoid unwarranted cost to either parties to the transaction or the agencies involved.

In the case of an investigation, a determination is made whether there is credible evidence that a threat to national security may result from the transaction and whether there are existing laws, other than Exon-Florio and the International Emergency Power Act which provide adequate and appropriate authority to protect the national security. A report of the findings is then made to the President at the end of this period. He has fifteen days in which to consider the recommendations of the CFIUS and to take appropriate action.

Exon-Florio as pointed out earlier is intended to be a safety net under foreign acquisition of U.S. enterprises, to be used in cases where there is (1) "credible evidence" that a threat to national security may exist, and (2) that there are no other laws applicable or appropriate to protect national security.

The principal difficulty, at least for DoD, is the short time in which the CFIUS must conduct its initial review. This places an especially heavy burden on Defense. The Services and component offices generally assign CFIUS cases to one analyst as only one part of his job. That person may be handling as many as 5 cases at one time. He must contact various points within his

organization and get back to DTSA within ten working days. DTSA must follow up on each case. If a DoD entity has problem with a case, DTSA must work with it to determine the extent and possible remedies. If it is necessary to recommend an investigation or support another Agency request for an investigation, DTSA must prepare the justification and coordinate it with the other parts of DoD by the 23rd calendar day.

In spite of the limitations, DTSA has done a credible job of reviewing and evaluating about 650 cases between the period of 1988 and 1992. Of these 650, cases twelve cases had detailed reviews, a couple were withdrawn and on the recommendation of CFIUS, the President blocked one foreign acquisition case that of MAMCO by China National Aerotechnology Import and Export Corporation (CATIC).<sup>39</sup>

### **Foreign Investment and its impact on National Security and the Industrial Base**

The risk alleged to be posed by international direct investment to U.S. National Security and the industrial base tends to fit two categories. First of all, there is the danger of some sudden, politically motivated action by the foreign investors that would bring key defense production to a halt in an effort to create a crisis, or to destabilize the U.S. in the event of one. Secondly, there is the threat of a gradual erosion of industrial capacity, brought on either through ill fortune or design, which would impede U.S. abilities to meet key peacetime modernization goals, or slow down industrial mobilization in the event of war. In reality, the first of these risks is not significant. U.S. industry remains sufficiently competitive, diversified, and resilient to handle any pressure that could suddenly be brought to bear through even the most carefully

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<sup>39</sup> Information from DTSA office

coordinated of strategies by international investors. Foreign direct investment constitutes only about 5 percent of all U.S. corporate assets,<sup>40</sup> and is excluded from many strategic industries by specific sectoral controls.<sup>41</sup> Factories, minerals in mines, and other physical plants cannot be picked up and moved overseas overnight, but must either be sold or closed. If they are sold, there will be other investors willing to buy them, and domestic production would go on. Any crisis brought on by foreign attempts to limit supplies of a material resource produced by the firm would increase the profitability of operations for the new owners, and give them incentive to set up production. On the other hand, attempts to close key production facilities during a crisis could be responded to quite adequately under the International Emergency Economic Power Act. Under these laws, the U.S. government can if necessary, seize control of industrial production facilities, and do whatever is required to maintain adequate production levels.

The risks of a gradual erosion of the defense industrial base are also significantly reduced by the factors listed above. However, in the case of a slow decline in industrial capacity, it would be more difficult to resort to emergency powers or the Defense Production Act to prevent the closing of operations, or the conversion of operations to non-strategic uses under peaceful, non-crisis circumstances. There is always the risk of loss of technological lead or theft of trade secrets if not carefully protected. Software is very vulnerable and a billion dollar secret could be stolen on a single floppy disk. American companies must realize that, as they become more involved in

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<sup>40</sup> E. Richardson, "Destiny Isn't Going Out the Window; Buying of America Is In Control And Helps Industry, Finance," *The Los Angeles Times* 31 July 1988, opinion section, part 5, at 5.

<sup>41</sup> Sectoral controls severely regulate limit or prohibit foreign direct investment in communications, nuclear power, aviation, COMSAT, LANDSAT, Water-borne transportation and radio broadcasting. Also see above article for detailed discussion.

international business, mergers, takeovers etc., their employees and technology become increasingly exposed to risks with which they did not have to contend in the past.

Although the probability of major risks to national security arising from temporary gaps in industrial capacity brought on by international direct investment is slight, prudence nevertheless dictates that some effort be undertaken to monitor developments in this area.

Most technology transfer problems that are disclosed by a CFIUS investigation would likely be handled under the authority of other law, there may be a few circumstances where resorting to Exon-Florio may be appropriate. Acquisitions need not directly involve high technology or classified assets to pose an intelligence or technology security risk. Eastern bloc intelligence services have benefited from the use of a wide variety of legitimate businesses as fronts for intelligence operations. For example, the Soviet Union had attempted to purchase several banks in the Silicon Valley through a middleman.<sup>42</sup> Through such an acquisition, then Soviet intelligence services could acquire information about financial transactions among defense contractors, subcontractors and the government. Such information could be helpful in piecing together which components are going into leading edge defense systems. It would have also given the Soviets information about technological developments in firms seeking loans from the institutions. Perhaps, most significantly, it would have given the Soviets valuable data about the financial circumstances of individuals working for high-tech firms that could prove useful in efforts to undermine their loyalty.

Suppliers of certain unclassified technological components to key defense industrial sectors and research facilities might be in a position to gain insights into production levels, and research

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<sup>42</sup> See Foreign Investment in the US: Hearing Before the Sub comm. On Economic Policy and Trade of the House Comm. On Foreign Affairs, 100th Cong. 2nd. Sess. (22 Sept. 1988) Statement of Dr. Susan Tolchin.

and development directions, and pass this information on to other foreign entities. Transfers of such data sometimes can even be accomplished without running afoul of export control laws. Of course, contracts to supply technological components for industrial research and production often include secrecy in connection with contract performance. However, the mere existence of a private cause of action would probably not provide an adequate deterrent for the activities of foreign governmental and industrial intelligence organizations. Thus, Exon-Florio may have some applications where there is a strong opportunity for this type of activity to occur.

### Conclusion/Recommendation

Few issues are tackled with as much emotion as foreign investment in the United States. Let us briefly see the French approach to foreign investment. With the intention of creating jobs for more than 12 percent of its workers who are unemployed, France has launched an all-out campaign to attract *foreign investment*. More than anything, France's high unemployment rate has forced the country to take a more active role in promoting foreign investment. France's development agency, Delegation a l' Aménagement du Territoire et a l' Action Regionale (DATAR), now does everything from identifying possibilities to offering tax incentives and grants. When a foreign acquisition case arises national security concerns, Defense and other government entities satisfy the concern. In 1993, foreign investment generated 15,425 new jobs in France - an all-time record. Preliminary figures from DATAR put total foreign investment in 1993 at \$10 billion. Of the 437 billion US companies invested abroad in 1992, \$2.8 billion went to France.<sup>44</sup> Similarly, Britain actively solicits foreign investment. Both countries agree that in

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<sup>44</sup> Industrial Business, May 1994, Issue 5, Page 56.

light of economic stability they cannot afford to say no to foreign investment. It brings in a huge capital inflow.

The United States Congress is concerned over foreign investment. Hopefully not from pressure from its constituents but from an understanding of the need to protect our companies who are performing high technology research and development from possible demise. National security involves our economic security and military security. We must protect our critical technologies at their earliest stages to maintain our technical and industrial leadership. The Exon-Florio review of foreign acquisitions focuses heavily on critical technologies in assessing any national defense impacts. However, the financial well being of the U.S. company must be carefully considered in the event the foreign investment is denied because a national security impact has been determined. If the U.S. company folds, that may be a *greater loss*. There are other solutions where precautions are taken to protect the high technology aspects of the U.S. company. These precautions range from selling the high technology part of the company to another U.S. concern to classifying the technologies. Many times, the high technology piece of the company is just a small fraction of its gross business.

We as a nation must be concerned with foreign direct investment into our high technology companies if for no other reason than there is a high likelihood that there will be an erosion of the long term U.S. research capability in both people and leading edge research opportunities. Strict protectionism is not the answer. On the other hand, relying on free market forces which may ultimately solve the problem is not the solution either, because we may have a national disaster while the market sorts itself out. The high technology capabilities of our nation deserve some special consideration. There is a legitimate concern over the erosion of industrial base and its

effect on national security. But this erosion cannot be blamed on foreign investment, the weakening of the defense base has happened because domestic companies have not kept pace with foreign competition-and thus lost market share to domestic subsidiaries of foreign companies. Yet we cannot afford to be dependent exclusively on a foreign supplier of critical advanced technology. We cannot be at the mercy of any firm that monopolizes a product that is key to the defense effort, whether that firm is domestically controlled or foreign controlled. National security has, to be carefully defined, and care must be taken so that it is not used as an excuse to block a legitimate foreign takeover.

The United States has traditionally pursued an open door policy towards foreign investments and has been at the forefront in pressing other countries to reduce their restrictions. From a global viewpoint, unrestricted movement of a capital (open competition between foreign-based and U.S.-based firms), like free trade, is advantageous because it promotes an efficient allocation of productive resources worldwide. Each equity investment in U.S. by foreign capitalists represents a careful judgment on where their money will earn the highest profit in the years ahead. They are deciding to put their money in America. Each of these investment decisions is a vote of confidence in the future of the American economy. In the Global 90s our relation with the rest of the world will hinge more on trade and economics, less on military and political considerations. However, a key trade policy question for the United States in the 1990s and beyond is, whether it remains willing and able to champion global goals even when this requires some sacrifice of perceived national needs.



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